No. 371

In the Supreme Court of the United States

OCTOBER TERM, 1944

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*

v.

JOHN H. SMITH, *Respondent*

RESPONDENT'S BRIEF

FRANKLIN T. GRIFFITH,
EARL S. NELSON,
CLARENCE D. PHILLIPS,
Attorneys for Respondent.

805 Electric Building,
Portland, Oregon.

Of Counsel:

GRIFFITH, PECK, PHILLIPS & NELSON,
805 Electric Building, Portland, Oregon.

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RESPONDENT'S BRIEF

This case comes before this court upon the petition of the Commissioner of Internal Revenue for writ of certiorari which was granted by the above court on October 16, 1944, and the case transferred to the summary docket.

OPINIONS BELOW

Memorandum opinion of the Tax Court is not officially reported but included in the Record (R. 21-37). Opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 142 Fed. (2d) 818.

JURISDICTION

The petition for writ of certiorari was premised upon a purported conflict of decisions between the Ninth Circuit and the Sixth Circuit. The objection of the respondent to the assumption of jurisdiction in this case, and the reasons therefor, were given in re-

spondent's brief opposing the petition for writ of certiorari which has been filed in the Court and cause.

STATEMENT OF CASE

The Commissioner of Internal Revenue assessed deficiencies for the calendar years 1938 and 1939, asserting that the Taxpayer had received income in the amount representing the difference between the option price fixed in 1934 and the market values of the stock received by the Taxpayer in the years 1938 and 1939. The Tax Court of the United States held in favor of the Commissioner (R. 21-37). This decision was appealed to the Circuit Court of Appeals for the Ninth Circuit and that Court reversed the Tax Court on the issue concerning this common stock, the opinion being reported as *Smith v. Commissioner of Internal Revenue*, 142 *Fed.* (2*d*) 818.

The statute involved in this case is *Section* 22 (*a*) *of the Revenue Act of* 1938 shown in historical note. *Title* 26, *Section* 22, *page* 47, *U .S. C. A.*, which reads as follows:

> "Sec. 22 (a). General definition. 'Gross income' includes gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the

transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing compensation of such Presidents and judges are hereby amended accordingly."

This section of the statute was amended sightly in 1939, but the effect of the amendment only involved employees of States or political subdivisions thereof.

Title 26, Sec. 22 (a) U. S. C. A.

The respondent, herein referred to as "Taxpayer," and so referred to in the Record, is a resident of Portland, Oregon, and filed his income tax returns for the years 1938 and 1939 at the Office of the Collector of Internal Revenue in Portland, Oregon. During the years 1934 to 1939 inclusive, the Taxpayer was an employee of Western Cooperage Company and at the time of the hearing in the Tax Court he was general manager of said Company (R. 41, 42, 43, 93).

Prior to 1933 Hawley Pulp & Paper Company, hereinafter referred to as Hawley Company, experienced financial difficulties and various committees representing the creditors, bondholders and stockholders were attempting to reorganize the company (R. 43) and the company was ultimately reorganized under the provisions of 77 B. of the Bankruptcy Act (R. 46).

Prior to the reorganization, a bondholders committee had been organized and the Western Cooperage Company was the owner of some of the bonds. At that time, and until the time of his death, Watson Eastman was president and general manager of Western Cooperage Company (R. 44, 45). Under the reorganization, as effected by the court proceedings under Section 77 B. of the Bankruptcy Act, the Western Cooperage Company was to manage the Hawley Company (R. 46, 47). Portions of the reorganization indenture applicable to this proceeding are included in Petitioner's Exhibit 1 (R. 50-71). The provisions of paragraphs "L" and "N" (R. 65, 68) are explained by one of the witnesses Cassius R. Peck (R. 123-127) showing that the Western Cooperage Company was to receive for its managerial services 174,378 shares of common stock of the Hawley Company upon the retirement of certain of the indebtedness (R. 85, 127). The common stock was represented by voting trust certificates. Pursuant to the plan of reorganization 174,378 shares of the Hawley Company's common stock was deposited with the depository, The Bank of California National Association. The voting trust certificates representing these shares were to be delivered to Western Cooperage Company under the reorganization agreement, upon performance of the agreement.

On December 10, 1934, Watson Eastman, president and general manager of Western Cooperage Company, gave to John H. Smith an oral option to purchase the right to receive all of the common stock of Hawley Pulp & Paper Company which the Western Cooperage Company would be entitled to receive in excess of 100,001 shares (R. 74-76, 115). The terms of this option were reaffirmed by the Board of Directors on May 4, 1937 (R. 77-82) and a written option agreement was entered into (R. 82-86) which embodied the terms of the oral agreement. This option granted to John H. Smith, his heirs or assigns, the right to purchase on or before January 1, 1940, the right to receive all of the common stock of Hawley Company in excess of 100,001 shares of common stock of the Hawley Company to be received by the Cooperage Company. The option price was fixed at $7,437.70, which was at the rate of ten cents per share for the 74,377 shares which would be available out of the stock acquired by Western Cooperage Company if and when they performed the agreement. The option price was equal to or in excess of the market value as of the date of the option on December 10, 1934 (R. 90-92, 101, 102, 118-121, 130).

On or about March 19, 1938, John H. Smith exercised his option to purchase and paid to the Western

Cooperage Company the sum of $7,437.70, which was included in a check shown as Exhibit 4 (R. 88, 89). In 1938, pursuant to the terms of the option agreement, the Taxpayer received voting trust certificates representing 33,759 shares of the Hawley common stock (R. 28). In 1939, pursuant to the same agreement, the Taxpayer received, at various dates, voting trust certificates representing additional common stock or a total number of 12,374 shares received in 1939 (R. 28), in accordance with demands made upon the depository (R. 94-101). Pursuant to such transactions the Western Cooperage Company made appropriate entry on its books showing the sale of the said common stock to the respondent for the sum of $7,437.70 (R. 141-153).

The option was not given for any service rendered in 1938 or 1939 or for services rendered in any year subsequent to 1934, but was only an honorarium for services which John H. Smith had performed in assisting the reorganization prior to December 10, 1934, all of which is recited in the resolutions of the Board of Directors and the option agreement itself (R. 76-86, 92, 95). The shares of stock were not given as the consideration for any services, but were transferred only pursuant to the option agreement. The option itself was the only consideration given for any services.

The Western Cooperage Company did not report

or attempt to take any deduction for any additional compensation paid to John H. Smith for the calendar years 1938 or 1939 (R. 93, 133, 134).

At the time the option was given on December 10, 1934, the market value of the common stock was less than ten cents per share (R. 90-92, 101, 102, 118-121, 130). In 1938 the common stock of Hawley Company had increased in market value and again increased in the year 1939 (R. 29, 109-113).

The future employment of John H. Smith by the Western Cooperage Company did not depend on the option (R. 95), and the option ran, not only to John H. Smith, but to his heirs or assigns (R. 82-86).

In the years 1940 and 1941 John H. Smith sold part of the common stock which he had purchased pursuant to the option agreement. He reported the profit thereon in his income tax returns for the respective years of 1940 and 1941, taking as a basis for the computation of profit the amount of ten cents per share which he had paid as the agreed price of said stock under the option agreement (R. 93, 94, 95).

ARGUMENT

The fundamental question in this case is whether or not the Taxpayer received taxable income in the years 1938 and 1939. In determining this question the Court must necessarily take into consideration the intentions of the parties as manifested by their words and actions with respect to the transaction in question. It must be remembered that the option was the only thing which was given to John H. Smith in 1934 and constituted the only compensation for any service that he rendered in connection with the attempted reorganization of the Hawley Company. Such services were all rendered prior to December 10, 1934. The option agreement itself was of negligible, if any, value. However, it could be sold by John H. Smith immediately, or, in case of his death, it would descend to his heirs or legatees. Under the circumstances it can hardly be said that it was the intention of the parties that the increase in value accruing to the stock between 1934 and 1938 should be considered as compensation to the Taxpayer when in case of a sale of the option by the Taxpayer, or in case of his death, such increase in value would accrue to a stranger to the transaction, who would not be an employee of Western Cooperage Co. It is also obvious from the arrangement made and particularly the provisions of the reorganization agree-

ment under which the Western Cooperage Company was to receive this stock, that no more than an option could be given. The Western Cooperage Company did not own the Hawley stock in 1934. They only had the right to receive stock if and when they performed under the reorganization agreement. In other words all that the Western Cooperage Company could agree to sell to John H. Smith in 1934 was their contingent right to receive the Hawley stock and delivery of the stock thereunder necessarily had to be postponed until such a time as the Western Cooperage Company was entitled to receive actual delivery of the voting trust certificates representing the stock.

This Court in defining the definition of income as referred to in the XVI Amendment and as provided for in Section 22 (a) of the Revenue Act has consistently followed the rule of including income only as it was actually received and not imposing a tax upon a fictious income.

In *Eisner v. Macomber*, 252 *U. S.* 189, 207, 40 *S. Ct.* 189, 64 *L. Ed.* 521, this Court defined income as follows:

> "Brief as it is, it indicates the characteristic and distinguishing attribute of income, essential for a correct solution of the present controversy. The government, although basing its argument upon the definition as quoted, placed chief em-

> phasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived—*'derived-from-capital;'* —*'the gain-derived-from-capital,'* etc. Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being *'derived,'* that is, *received* or *drawn* by the recipient (the Taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers the description.'
>
> "The same fundamental conception is clearly set forth in the 16th Amendment—'incomes, *from* whatever *source derived*,'—the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the Constitution."

The above definition followed in general that given by this court in *Doyle* v. *Mitchell Bros. Co.* 274 *U. S.* 179, 185, 38 *Sup Ct.* 467, 62 *L. Ed.* 1054.

These decisions were followed by that of *Merchants' Loan & Trust Co. v. Smietanka*, 225 *U. S.* 509, 519, 41 *Sup Ct.* 386, 65 *L. Ed.* 751, where the Court said:

> "In determining the definition of the word 'income' thus arrived at, this court has consistently refused to enter into the refinements of lexicographers or economists, and has approved, in the definitions quoted, what it is believed to be the commonly understood meaning of the term which

must have been in the minds of the people when they adopted the 16th Amendment to the Constitution. Doyle v. Mitchell Bros. 247 U. S. 179, 185, 62 L. Ed. 1054, 1059, 38 Sup. Ct. Rep. 467; Eisner v. Macomber 252 U. S. 189, 206, 207, 64 L. ed. 521, 528, 529, 9 A. L. R. 1570, 40 Sup. Ct. Rep. 189. Notwithstanding the full argument heard in this case and in the series of cases now under consideration, we continue entirely satisfied with that definition, and, since the fund here taxed was the amount realized from the sale of the stock in 1917, less the capital investment as determined by the trustee as of March 1, 1913, it is palpable that it was a 'gain or profit' 'produced by,' or 'derived from,' that investment, and that it 'proceeded,' and was 'severed' or rendered severable, from it, by the sale for cash, and thereby became that 'realized gain' which has been repeatedly declared to be taxable income within the meaning of the constitutional Amendment and the Acts of Congress. Doyle v. Mitchell Bros. Co. and Eisner v. Macomber, supra."

This court has also indicated that in gain or profit realized from personal property, the gain or profit resulting in taxable income is determined at the time of the sale of the personal property.

Goodrich v. Edwards, 255 *U. S.* 536, 41 *Sup. Ct.* 392, 65 *L. Ed.* 762.

Further definition of income was given by this court in *Bowers v. Kerbaugh-Empire Co.*, 271 *U. S.* 170, 46 *Sup. Ct.* 449, 70 *L. Ed.* 886. See, also, *Taft v. Bowers*, 278 *U. S.* 470, 481, 49 *Sup. Ct.* 199, 73 *L. Ed.* 460

This Court has also pointed out that with respect to gains or losses for income tax purposes that attention should only be given to realities and that gains and losses should only be reflected for purposes of income tax when they become realized gains or realized losses.

> *Weiss v. Weiner*, 279 *U. S.* 333, 49 *Sup Ct.* 337, 73 *L. Ed.* 720; *Lucas v. American Code Co.*, 280 *U. S.* 445, 50 *Sup. Ct.* 202, 74 *L. Ed.* 538; *Burnet v. Logan*, 283 *U. S.* 404, 51 *Sup. Ct.* 550, 75 *L. Ed.* 1143.

In *McLaughlin v. Alliance Insurance Co.*, 286 *U. S.* 244, 52 *Sup. Ct.* 538, 76 *L. Ed.* 1083, this Court summed up this principal as follows:

> "The tax under this and earlier revenue acts was imposed upon net income for stated accounting periods, here the calendar year 1928, see Burnet v. Sanford & B. Co., 282 U. S. 359, 363, 75 L. Ed. 383, 386, 51 S. Ct. 150, and it is only gain realized from the sale or other disposition of property, which is included in the taxable income. Realization of the gain is the event which calls into operation the taxing act, although part of the profit realized in one accounting period may have been due to increase of value in an earlier one. While increase in value of property, not realized as gain by its sale or other disposition, may, in an economic or bookkeeping sense, be deemed an addition to capital in a later period, see Merchants' Loan & T. Co. v. Smietanka, 255 U. S. 509, 65 L. Ed. 751, 15 A. L. R. 1305, 41 S. Ct. 386, it is nevertheless a gain from capital investment which, when realized, by conversion into money or other

property, constitutes profit which has consistently been regarded as income within the meaning of the Sixteenth Amendment and taxable as such in the period when realized. See Lynch v. Hornby, 247 U. S. 339, 62 L. Ed. 1149, 38 S. Ct. 543; Merchants' Loan & T. Co. v. Smietanka, 255 U. S. 509, 65 L. Ed. 751, 15 A. L. R. 1305, 41 S. Ct. 386, supra; Eldorado Coal & Min. Co. vs. Mager, 255 U. S. 522, 65 L. Ed. 757, 41 S. Ct. 390; Goodrich v. Edwards, 255 U. S. 527, 65 L. Ed. 758, 41 S. Ct. 390; Walsh v. Brewster, 255 U. S. 536, 65 L. Ed. 762, 41 S. Ct. 392; Taft v. Bowers, 278 U. S. 470, 73 L. Ed. 460, 64 A. L. R. 362, 49 S. Ct. 199; Lucas v. Alexander 279 U. S. 573, 73 L. Ed. 851, 61 A. L. R. 906, 49 S. Ct. 426; Willcuts v. Bunn, 282 U. S. 216, 75 L. Ed. 304, 71 A. L. R. 1260, 51 S. Ct. 125."

The Commissioner of Internal Revenue, in this case and in his application for writ of certiorari, sought jurisdiction upon the ground that there was a conflict of opinions between the several circuits. It is true that some of the Circuit Courts of Appeal have determined that income accrued to employees or stockholders of corporations in the event that they received stock or property from the corporation at less than the then market value. This court, however, will find, upon examining these cases, that they fall generally into three catagories. The first group of cases deals with transactions where the stock itself was either given or sold at a "bargain purchase" price and was frankly given with the intention by the parties that the difference between the purchase price and the market value should

be considered as compensation or additional compensation to the employee or stockholder. In another group of cases, the option agreement expressly provides that the increase in value between the purchase price and the market value was intended by the parties as compensation or additional compensation. The third group of cases deals with sales under options to an employee or stockholder without any manifest intent of the parties that the increase in value, if any, should be considered as compensation to the employee or stockholder. These several cases will be analyzed herein.

However, it must be remembered that the facts in this case show that the only compensation, although it was of doubtful and negligible value, was the option itself, given to the Taxpayer in 1934 for services rendered prior to December 10, 1934. It was not the intention of the parties that the increase in value, if any, should be considered as compensation to John H. Smith. In fact no one could know that there would be any increase in value. As shown by the record and the reorganization agreement the days of 1934 looked very dark for the Hawley Pulp & Paper Company. The intent of the parties was further evidenced by the terms of the option agreement itself and the reorganization indenture, which pointed out that the Western Cooperage Company could not possibly receive title to the Hawley stock until after it had performed its obliga-

tions under the reorganization indenture. This option ran to John H. Smith, and also to his heirs and assigns, which would permit him to sell the option if he so desired. In case of a sale of the option, after the granting thereof and prior to the delivery of any stock under said option, his assignee upon payment of the option price, would be entitled to demand delivery of the shares covered by the option. The increase in value received by such assignee could certainly not be considered as compensation for any services rendered by John H. Smith. In case of the death of John H. Smith prior to the delivery of any stock under said option, the executors, heirs or legatees of John H. Smith could, upon payment of the option price, compel delivery to them of such stock. The increase in value received by such executor, heir or legatee would not be considered as compensation for any services rendered by John H. Smith. He performed no services in 1938 or 1939 for which this might be considered as compensation. He was paid his regular salary during 1938 and 1939 for what services he did perform. He paid for the full block of stock in 1938 and there was nothing left for him to do after that time of exercising his option except to take delivery of the stock, if and when the Western Cooperage Company became entitled to receive it. The Western Cooperage Company reflected in its accounts only the actual amount received from the stock

at the purchase price of ten cents per share and the Western Cooperage Company did not attempt to make any deductions in the years 1938 or 1939 for any additional compensation to John H. Smith.

In this case the Commissioner takes the position that John H. Smith ultimately received capital stock as compensation. The facts in the case show that the most that he received for compensation was only an option to purchase shares at the then market price. There is a distinction between the option and the property acquired under the option as determined by this Court in *Helvering v. San Joaquin Fruit & Investment Co.*, 297 U. S. 496, 56 *Sup. Ct.* 569, 80 *L. Ed.* 824, where this Court said:

> "We hold that the respondent acquired the property on November 30, 1916. The option itself was property, and doubtless was valuable. If it had been assignable, and the lessee had sold it at a profit, taxable gain would have resulted from the sale. But the option is admittedly not the same property as the land. So conceding, the respondent still insists that ownership of the option created an interest in the land. This would not be true of a bare option unconnected with a lease; but we are told that because embodied in the lease the agreement became a covenant real and gave the lessee a species of interest or property in the land. The weight of authority is to the contrary, and no cited California decision supports the position. But even if we should agree that a lessee-optionee acquires, by virtue of the instrument, an equitable interest in the land it would not follow that, within the

> contemplation of the revenue acts, he acquires the property at the date of the option rather than at the date of conveyance. The word 'acquired' is not a term of art in the law of property but one in common use. The plain import of the word is 'obtained as one's own.' Language used in tax statutes should be read in the ordinary and natural sense. In the common and usual meaning of the term the land was acquired when conveyed to the respondent's predecessor."

The Tax Court has now adopted the same rule in the case of *J. Gordon Mack*, 3 *T. C.* 390. The proper rule by which to determine taxable income would not be market value at the time of acquisition of capital assets but would be determined at the time of the sale thereof, and would be the difference between the cost and the sale price.

In 1940 and 1941 John H. Smith sold some of this common stock. He did not attempt to use as a basis for his profit the 1938 or 1939 values (as has been attempted by some taxpayers in some of the reported cases), but he took as a basis in computing his profit the actual amount that he paid therefor of ten cents per share as the agreed price in the option, which was the market price at the time of the option in December, 1934. The *Revenue Act, U. S. C. A., Title* 26, *Section* 113, with respect to the determining of gain or loss on capital assets points out that "the basis of the property shall be the cost of such property." This statute gives a clue

to the intent of Congress with respect to the definition of income, and the Taxpayer in this case has followed that rule in his transactions on the Hawley stock. We venture to suggest that if the Taxpayer had attempted in 1940 and 1941 to use, as a basis in computing his profits, the market value of these stocks in 1938 and 1939, the Commissioner would have strenuously objected thereto and would have insisted that the Taxpayer use the original cost of ten cents per share as the basis of computing his profit or loss.

If any other rule is adopted in this case, the Taxpayer would be required to pay a tax upon a fictitious income which he might or might not ever receive. The market value of these stocks in 1938 went up to $2.50 per share and in 1939 the market values varied between $4.00 per share and $6.75 per share (R. 109-113). It is conceivable that the market value of this stock may drop to a lower figure before the Taxpayer ever disposes of his stock. If it does, he would be in a position of having to pay a tax upon a fictitious profit which he never received. The only sound rule to adopt generally for income tax purposes is that which has already been announced by this Court in the cases above cited, that gains and profits for income tax purposes should only be determined when the profit is converted from capital into money at the time of sale.

This rule was well pointed out by the Circuit Court of Appeals for the Seventh Circuit in *Commissioner of Internal Revenue v. Wood*, 107 *Fed.* (2d) 869, *where* the repossession of real property under a lease was considered, and the Court said:

> "In such cases, common sense dictates that the taxpayer by necessity must wait for his income until there is a conversion into cash or its substantial equivalent. See Eisner v. Macomber, 252 U. S. 189, 207, 208, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. Nor does such a construction of the taxing statute work a disadvantage to the Government. The Government will collect its tax, if the taxpayer sells or exchanges the property. On the other hand, if the taxpayer elects to hold the property upon repossession, the Government will tax the entire earnings therefrom, as long as the building is valuable enough to produce net income."

With respect to the several Circuit Court cases upon which the Commissioner has relied, the Court will observe in the facts of each case, the distinguishing characteristics which indicate that the Circuit Courts have not been inconsistent in following the rules already announced by this Court.

In the case of *Crowell v. Commissioner of Internal Revenue*, 62 *Fed.* (2d) 51, stock was given to certain employees "to supplement their cash salaries." No option was involved.

In *Indianapolis Glove Co. v. United States, Ninth Circuit*, 96 *Fed.* (2d) 816, 819, stock was issued in the

name of employees and the employees gave to the corporation their demand notes, but the employees were told that the notes would not be collected and that they were to be paid entirely from stock dividends when such dividends were sufficient for such purpose. The Court found that the parties had agreed that the notes would not be paid and the purpose was to give additional compensation.

In *Mason* v. *Commissioner of Internal Revenue*, 125 *Fed.* (2d) 540, the corporation agreed to sell stock to an employee at $10.00 per share on January 15th of each year, which was part of the compensation set forth in his agreement, and the agreement (contrary to the facts of the instant case) was to be terminated upon his death.

In *Alger Soloman Lumber Co.* v. *Commissioner of Internal Revenue, Fifth Circuit*, 57 *Fed.* (2d) 3, the company transferred 150 shares of capital stock to four of its employees. They were treated as extra compensation and were deducted by the corporation as an expense of doing business. The Commissioner claimed that the transfers were outright sales and not deductible. The stock itself was held in the treasury of the company until they were paid for by the application of cash dividends.

In Olsen v. *Commissioner, Seventh Circuit*, 67 *Fed.* (2d) 726, shares of stock were issued to employees and

held by the compnay under an agreement that the employees who received the stock should remain continuously in the employ of the company for a period of five years, and the company retained the right to repurchase the shares in event of the death of any of the named employees.

In *Robinson* v. *Commissioner of Internal Revenue, Sixth Circuit*, 59 *Fed.* (2d) 1008, the employee had worked for several years at no salary whatever or at a nominal salary, and the stock was sold to him at a price less than market value for the purpose of making it more attractive for the employee to stay with the company.

It is obvious that the decisions in these cases are based upon facts which differ entirely from the facts and conditions of the instant case.

Some reliance is also placed by the Commissioner on the case of *Gibson* v. *Commissioner*, 133 *Fed. Rep.* (2d) 308. In that case the taxpayer, as a stockholder of a company, had an option under which stock could be acquired. She sold the option, and the difference between the option price and the proceeds of the sale of the option constituted income. The writ of certiorari was dismissed in the Gibson case by this Court in the October term, 1943, 88 *L. Ed.* 22. The same rule would apply in this case if John H. Smith had sold his option.

He would have been required to report as income any profit he made over and above the option price. In fact, he did report his full profit in 1940 and 1941 on the sale of any stock sold in those years which he had acquired by reason of his option (R. 93, 94, 95).

The Commissioner also places much reliance upon the decision of the Circuit Court of Appeals for the Sixth Circuit in *Connolly's Estate* v. *Commissioner*, 135 *Fed.* (2d) 64. The facts in the Connolly case strongly indicate that it was the intention of the parties there, by reason of options, to provide additional compensation to employees by way of the increased values which accrued to the stock under the options. From the decision of the Circuit Court the facts which differentiate that case from the instant case appear as follows:

(a) At the time the options were granted the market value of the stock was nearly two and one-half times the option price;

(b) The employer in the Connolly case had voluntarily reduced the fixed salaries of certain employees, including Connolly, during a five-year period preceding the time of the granting of the options, and the designated employees, including Connolly, were then serving the corporation at a rate of fixed compensation greatly disproportionate to the value of their services;

(c) The option entitling the employees to purchase at a price less than the market value was given as ad-

justed compensation for services "heretofore rendered, and as an inducement to said Messrs. Hoagland and Connolly to continue in the employ of the corporation";

(d) The resolution revising the terms of the options recited that the revision was necessary if Hoagland and Connolly, through the medium of options, were to receive purchase rights which "in any real sense" would constitute compensation for valuable services theretofore and then being currently rendered by them to the corporation.

(e) The minutes of the corporation also recited that the services rendered had greatly exceeded in value any compensation received by them, and that the best interests of the corporation would be served by the "continued willingness of these persons to serve the corporation and to exercise in the administration of its affairs the same degree of time, effort and skill as heretofore, and as an inducement to that end," the Board of Directors granted the options "by way of adjusted compensation."

The Court will observe in the Connolly decision, that even at the time the options were granted, the market value of the stock was far in excess of the option price. The market value, at that time, was nearly two and one-half times the option price. The parties recognized that there was an excess value and such excess was in the nature of compensation for services being

presently rendered and to be rendered in the future by the employees. In such a case the employer adjusts his records accordingly and makes the allowable deductions for compensation paid. The Tax Court now declines to follow the Connolly case, as shown by the decision of *J. Gordon Mack*, 3 *T. C.* 390.

In the instant case, however, there was no intent by any of the parties, either John H. Smith or the Western Cooperage Company, to pay additional compensation in 1938 or 1939 to John H. Smith by reason of any values which had accrued to the stock which he had a right to purchase under his option. After the option was given in 1934, the rights of John H. Smith were the same as would be the rights of any stranger to the Western Cooperage Company. He had a contract which he could enforce and under which he could purchase the Hawley stock. He had a contract which he could assign and which could be enforced by his heirs and legatees in the event of his death. These facts preclude any suggestion of compensation in the years 1938 and 1939.

The Circuit Court of Appeals for the Ninth Circuit correctly determined these issues in its opinion in the case below, *Smith* v. *Commissioner of Internal Revenue*, 142 *Fed.* (2d) 818.

That Court followed the reasoning of the Board of Tax Appeals, and the several Circuit Courts of Appeal,

in cases with comparable facts, as well as having followed the substantive rules announced by this Court.

One of the early cases upon this subject is *Delbert G. Geeseman*, 38 *B. T. A.* 258, 264, where the Board of Tax Appeals held that the acquisition of such stock under an option did not constitute the receipt of compensation. In its opinion the Board said:

> "It is true that the prospective purchasers were selected solely because they were valued employees of Continental Can Co., and there is no doubt that the added interest of these employees and the proprietary attitude toward the company which would result from their ownership of the stock constituted one of the motives for the granting of the option. It is equally obvious, however, that the continued employment of the petitioner was not dependent upon the receipt by him of the right to purchase the stock at less than the market price. The terms and conditions of his employment and the compensation he was receiving were in no way changed by the receipt of the privilege of purchasing the stock. Accordingly, the rule stated in the Erskine and Ritter Lumber Co. cases is not applicable here. Furthermore, the price to be paid by petitioner for the stock was substantial and if consideration be given to the language of the offer, the margin of difference between the option price and the current market price at the time the option price was fixed, and to the fluctuation of prices on the stock market during the period in which the offer was made, we do not believe that it can be said that the margin of difference between the offering price and the fair market value of the stock was so great as to require the conclusion that the transaction here constituted the payment of com-

pensation. Cf. Omaha National Bank v. Commissioner, 75 Fed. (2d) 434; Gardner-Denver Co., supra; and Rossheim v. Commissioner, 92 Fed. (2d) 247. Accordingly we are unable to find in the instant case the elements which would indicate that the transaction was not what its form indicates, that is, a purchase of stock by the petitioner with a view to the subsequent realization of profit through dividends or sale or other disposition of the property.

"The conclusion stated makes it unnecessary to consider the petitioner's alternative contentions.

"Decision will be entered for the petitioner."

See also *Gordon M. Evans* v. *Commissioner*, 38 *B. T. A.* 1406.

In the case of *Charles E. Adams*, 39 *B. T. A.* 387, 393, the option price was substantially the same as the market price at the date of the option. In holding that the petitioner did not have income by reason of exercising his option, the Court said:

"The option price was not substantially different from the fair market price at the date of the option. Indeed, the option was at a price slightly higher than the market price at the time. There was undoubtedly connection between petitioner's position as an employee and the granting of the option to him, but it did not amount by any means to the option being granted as compensation for services rendered. In Omaha National Bank v. Commissioner, 75 Fed. (2d) 434, referring to the optionee, it was stated:

"'* * * Undoubtedly he had been accorded this right of purchase because he was a valued em-

ployee of the company and it wished to retain his services * * *.'

"Yet it was held that the option was not compensation for services rendered. The distinction between compensation for services and the granting of an option to employees in order to benefit the company by making the employees more interested in the welfare of the company has, in that case and in Delbert B. Geeseman, Gordon M. Evans, and Rossheim v. Commissioner, all cited above, been fully, and we think soundly, set forth, so that further extended discussion is not here necessary. The situation in the present proceeding offers no difference in principle and no facts to indicate payment of compensation for services rendered, more than in the cases above noted. Indeed, in Gordon M. Evans, supra, there was some language indicating that the agreement was 'designed to compensate those who continue to give to the company their best efforts,' etc., though it was contradicted by other provisions of the agreement; whereas the evidence herein tends throughout, we think, to negative any agreement to compensate for services. Compensation for services was handled on a different basis, dependent upon the earnings of the corporation; the granting of the options to purchase stock had no such limitation. We think the situation amounted to nothing more than an incentive to loyal support of the organization much in the same manner as approved in the cases above cited.

"Respondent's reference to article 22 (a) (1) of Regulations 84 and to similar provisions in prior regulations does not, in our opinion, offer reason for deviating from the opinion already expressed above and in previous cases, for the various cases upon this subject have not permitted, and obviously should not permit, the regulations to add anything to the statute.

"We therefore hold that the petitioner did not have income in the taxable year represented by the difference between the option price and the fair market value of the stock in the corporation.

"Decision will be entered for the petitioner."

See also *Herbert H. Springford*, 41 *B. T. A.* 1001.

In the case of *Gardner-Denver Co. v. Commissioner*, 75 *Fed.* (2d) 38, the taxpayer corporation, in its tax return, endeavored to take certain deductions as compensation to employees, equal to the difference between the subscription price of the stock and the market value. The Commissioner objected to the deductions and was sustained by the Court, which, in its opinion, said:

"Petitioner maintains that while the propositions of employers and the acceptances by the employees are in the form of sale and purchase of the stock, all of the facts indicate that they were not such in essence; but that instead they disclose a purpose of making inducements to the employees for remaining in the employ, and thereby minimizing the labor turnover, to the distinct advantage of the employer, and that such advantage would be and was compensated to the employees by giving them the increase in value of the stock as a further compensation to them for their loyalty and continuous service during the period.

"There have been cases adjudicated where there was involved the question of bonus or additional compensation to employees through transactions whereby they purchased stock from their employers for less than market value. Without citing or discussing them, we think they do not have

application to a situation such as this. Nor are those cases in point where the question was as to the taxability to officers and employees of the excess in value of such stock over what such officers or employees had paid therefor.

"The finding here was that the market value of the stock at the time the agreement was made was substantially the stipulated subscription price to be paid by the employees. While there would thus at that time have been no advantage to the employees in respect to the purchase price, it is plain that any advantage to them consisted in the very easy terms on which they might pay for and acquire the stock.

"If at the time the agreements were made the market value of the stock had been substantially higher than the stipulated price, there might be ground for the contention that, notwithstanding the form of the contract, that difference was in contemplation as a bonus or added compensation to the employees, which, if reasonable, might be treated as such additional compensation or bonus, and deductible accordingly from gross income. See Article 128, Regulations 74 (promulgated under Revenue Act of 1928). *But where, as here, the conveyance of the stock was pursuant to an agreement between employer and employees for conveyance of stock to the employees when a specified price was paid, a subsequent increment in the value of the stock cannot be regarded as contemplated or actual additional compensation to the employees.* And in no event would such subsequent advance in value represent loss or outlay or expense to the corporation itself." (Emphasis ours.)

If the transaction in the instant case represented income to John H. Smith, it would likewise represent expense to, or compensation paid by, Western Cooper-

age Co., but under the decision in the Gardner case this would not be recognized as such compensation.

In the case of *Omaha National Bank* v. *Commissioner*, 75 *Fed.* (2d) 434, there was a contract under which an employee was entitled to buy stock at an agreed price under which the company was to allow credit on the purchase price. The Court held that the difference between credits and market value were not taxable gains until such time as the stock might be sold by the employee. The Court in its opinion said:

> "It is not easy to put out of mind the fact that by 1928 the stock which the taxpayer had purchased in 1918 had become worth far more than the agreed purchase price, and that the taxpayer had a large paper profit as the result of his contract, which profit he could have realized by selling his stock. But if, instead of being worth more than the contract price, the 150 shares received had been worth $2,000, and if the taxpayer had reported in his income tax return the market value of the stock as additional salary instead of the $7,500 credited to him by his employer under the terms of the contract, would the Commissioner then have insisted that the $7,500 was a mere arbitrary credit? We think that he would not. He would very properly have contended that the company, by crediting the taxpayer with $7,500 in 1928, to apply upon the purchase price of the stock, had given him that much additional compensation, and that the taxpayer would not be entitled to a deduction for the loss represented by the difference between the $7,500 paid for the stock delivered to him and the $2,000 which it was worth, until that loss had been realized through a sale of the stock.

"The Commissioner and the Board have treated the transaction here involved as one in which the company in 1928 delivered 150 shares of stock to the taxpayer as additional compensation for services. *They have disregarded the contract.* The additional compensation which the taxpayer received was what he contracted for in 1918 and was the amount credited to him by his employer and with which he paid for the 150 shares of the 500 shares which he agreed to purchase. *The difference between the amount of the credit and the fair market price of the stock was not a taxable gain realized in the year* 1928, *since the stock was not sold by the taxpayer in that year.*

"Concededly, if the company had, without any previous agreement or understanding, credited the taxpayer with $7,500 and delivered to him the 150 shares of stock as additional compensation for his services, the realized gain would be the fair market value of the stock. Rodrigues v. Edwards (C. C. A. 2) 40 F. (2d) 408; Appearl of James R. Lister, 3 B. T. A. 475; Charles R. Johnston v. Com'r of Int. Rev., 8 B. T. A. 992; C. A. Tilt v. Com'r of Int. Rev., 14 B. T. A. 437; Old Colony Trust Co. v. Com'r of Int. Rev. (C. C. A. 1), 59 F. (2) 168. But where the stock was delivered under contract of purchase and the taxpayer became the owner of it because of his agreement to purchase, the difference between what he paid for the stock and what the stock was worth was not a taxable gain. Gardner Governor Co. v. Com'r of Int. Rev., 27 B. T. A. 1171; Durkee v. Welch (D. C. S. D., Calif.), 49 F. (2d) 339; Rose v. Trust Co. of Georgia (C. C. A. 5), 29 F. (2d) 767; Taplin v. Com'r of Int. Rev. (C. C. A. 6), 41 F. (2d) 545; Commissioner of Internal Revenue v. Van Vorst (C. C. A. 9), 59 F. (2d) 677. *It would become a taxable gain in the year that the stock was sold by the taxpayer, provided that the gain*

had not evaporated by that time." (Emphasis ours.)

In the case of *Rossheim v. Commissioner*, 92 *Fed.* (2d) 247, there was an option given to the corporate president to buy stock at approximately its market value, which value at the time of delivery was less than the market value. In holding that the taxpayer had no additional taxable income, the Court said:

> "The Board determined that Rossheim was liable for a deficiency of $45,690.83. It reasoned that since an option contract must be supported by consideration, the consideration must have been services, and that therefore the option amounted to a contract for services. Two members dissented from the majority opinion.
>
> "The majority opinion relied upon the cases of Albert Russel Erskine v. Com'r, 26 B. T. A. 147, and Omaha National Bank et al, Executors, v. Com'r, 29 B. T. A. 817. This latter case has, however, been reversed by the Circuit Court of Appeals for the Eighth Circuit since the Board published its opinion in the case at bar. Omaha National Bank v. Commissioner, 75 F. (2d) 434, 436. In reversing the decision of the Board, Judge Sanborn, speaking for the Court, said: 'Where the stock was delivered under contract of purchase and the taxpayer became the owner of it because of his agreement to purchase, the difference betwen what he paid for the stock and what the stock was worth was not a taxable gain. * * * It would become a taxable gain in the year that the stock was sold by the taxpayer, provided that the gain had not evaporated by that time.'
>
> "The other case relied upon by the Board in its majority opinion is clearly distinguishable from

the case at bar because the option was given for a price far below the actual value of the stock at that time. D. C. Bothwell v. Com'r, 27 B. T. A. 1351, 1356. But in the case before us, it was given at the approximate market price.

"There is no allegation or charge of bad faith with reference to either Rossheim or others connected with this transaction, nor is there any evidence that the option was given for any other purpose than that ascribed by Rossheim, namely, to give him, as an officer of the corporation, an opportunity to acquire a substantial interest therein, if he could effect a 40 per cent increase in the value of the stock

"Since the option was given at the approximate market value of the stock at that time and the sale of it was later made in good faith and in accordance with the terms of the contract, Rossheim did not receive any taxable income in 1928. *His first tax liability arose in* 1929 *and* 1930, *when he sold some of the stock at a profit which he reported.* Rose v. Trust Company of Georgia, 28 F. (2d) 767 C. C. A. 5); Taplin v. Commissioner, 41 F. (2d) 454 (C. C. A. 6); Durkee v. Welch (D. C.), 49 F. (2d) 339; Commissioner v. Van Vorst, 59 F. (2d) 677 (C. C. A. 9); Omaha National Bank v. Commissioner, supra; D. C. Bothwell v. Commissioner, supra.

"The order of redetermination of the Board of Tax Appeals is therefore reversed, and the income tax return of Rossheim is hereby reinstated." (Emphasis ours.)

In the case of *Rose, Collector,* v. *Trust Company of Georgia,* 28 *Fed.* (2d) 767, the Circuit Court of Appeals for the Fifth Circuit also pointed out that where a purchase was made in good faith no taxable income

would be derived until the disposal of the stock, and followed the rule announced in *Eisner* v. *Macomber*, 252 *U. S.* 189, 40 *Sup. Ct.* 189, 64 *L. Ed.* 521, and *McCaughn* v. *Ludington*, 268 *U. S.* 106, 45 *Sup. Ct.* 423, 69 *L. Ed.* 868.

In *Commissioner of Internal Revenue* v. *Van Vorst*, 59 *Fed.* (2d) 677, the Circuit Court of Appeals, Ninth Circuit, had under consideration a purchase of real property from a corporation by the principal stockholder thereof, and in which the question was raised as to the effect of the regulation relative to selling property by a corporation who was shareholder or by an employer to an employee and the Court pointed out that irrespective of the regulation, the statute itself and the Sixteenth Amendment to the Constitution would have to be followed and that there would be no taxable gain to the taxpayer until such time as he disposed of the real property so that his gain could be determined.

In the case of *Hawke* v. *Commissioner of Internal Revenue, Ninth Circuit*, 109 *Fed.* (2) 946, certain stock was purchased by employees and the Court there pointed out that there could be a bona fide sale from an employer to an employee and, if under the facts that it was not intended as additional compensation, any increase in value would not be taxable income under the statute and the Constitution and followed the rule laid

down by this Court in *Palmer* v. *Commissioner*, 302 *U. S.* 63, 58 *Sup. Ct.* 67, 82 *L. Ed.* 50.

The Court will note that under *Treasury Regulation* 101, promulgated under the *Revenue Act of* 1938, *article* 22 (a)—1 treats of the transfer of property by a corporation to a shareholder and by an employer to an employee. The underlying basic principle is the same in both instances. This Court has already determined the issue involved in this case by its decision in *Palmer* v. *Commissioner of Internal Revenue*, 302 *U. S.* 63, 58 *Sup. Ct.* 67, 82 *L. Ed.* 50. In its opinion this Court said:

> "They are at most options or continuing offers, potential sources of income to the stockholders through sale or the exercise of the rights. Taxable income might result from their sale, but distribution of the corporate property could take place only on their exercise. The question, then, is whether the distribution which results from the exercise of the rights must be regarded as a dividend if the reasonable value of the property at the time of exercise is more than the purchase price.
>
> "Second. We think that a distribution of assets by a corporation to its stockholders by means of a sale, to which it is committed by appropriate corporate action at a time when their sale price represents their reasonable value, is not converted into a dividend by the mere circumstance that later, at the time of their delivery to stockholders, they have a higher value. The meaning of §115 must be sought in the light of the situations to which it must be applied. It does not purport to withdraw

corporations and their stockholdehs wholly from the operation of §111-113, taxing the profits of purchasers. It cannot be taken to withhold from corporations the power at their own election to effect, by workable means, sales of their assets to stockholders at fair value, subject to that incidence of taxing statutes which usually attends sales. The distribution conte.nplated and defined by it as a dividend is one to be affected by corporate action. Hence, in determining whether a given transaction is 'sale' or 'dividend,' the corporate action which results in one or the other must be scrutinized at the time under which in practice it must be taken.

"The only feasible method by which a corporation of large membership can effect a sale of its assets to stockholders is by tendering to them rights to subscribe, a method whose indispensable first step is the adoption, by appropriate corporate action, of the terms of the offer. Between the dates of the first step and of subscription a substantial period of time must elapse, during which the rights may, and often do, become the subject of violent market fluctuations. Any vendor who offers property for sale at a named price, similarly carries the burden of risk that the property may increase in value between offer and acceptance. If the sale is by executory contract, he also carries the risk between promise and performance. It is an inseparable incident of every sale except those in which conditions admit of payment for the property simultaneously with its tender for sale, a procedure which may not be available to a corporation seeking to sell its property to stockholders.

"It is a solecism to speak of a corporation as distributing its profits for the sole reason that, after it has unavoidably assumed that risk in order to effect a sale of its property to stockholders at a fair price, the property increases in value. Price, which

in the present case is decisive of the issue, must be determined in the light of the situation existing when price is fixed. If the option price is fair when fixed the transaction is a tender for a sale and not for a distribution of profits—a dividend as defined by §115. If, pending execution of the plan, there were no change in value of the stock the transaction would throughout concededly retain its character as a sale. Its character is not altered by the fluctuations of a speculative market, after the corporate action which defines the character of the transaction has been taken.

"When the corporation has committed itself to a sale of its assets to stockholders at present market value the effect on its balance sheet is the same as in the case of other vendors who in various ways assume the risk of rising prices pending the consummation of the sale. In every case purchasers may, as a result of market change, acquire property at less than its value at the date of acquisition. But in the case of the corporation it does not follow that there has been a distribution of its profits. It can hardly be said that profits accrue to a corporation from a fortuitous gain in market value, the benefits of which it has relinquished before the gain occurs. Distribution of profits is neither the purpose nor effect of the action taken by the corporation and there is not adequate basis for saying that the transaction to which the directors committed their corporation was the distribution of earnings, and hence a dividend rather than a fairly conducted sale of corporate property with all the incidents which usually attend a sale when the price is fixed in advance of performance. It is decisive of the present case, so far as the first allotment of United shares is concerned, that distribution of corporate assets, effected by the sale, was not intended to be a means of distributing earnings,

and that the price when fixed represented the fair market value of the property to be distributed."

Likewise, in the present case, a contract was entered into between the Western Cooperage Company and John H. Smith on December 10, 1934, under which the Taxpayer was given the right to purchase 74,377 shares of common stock of the Hawley Co. The price was fixed at ten cents per share, which was equal to or in excess of the then market value. It was a bona fide contract and, if given by way of compensation, was only for services rendered prior to December 1, 1934, and the nature of the compensation was the option only. It was not within the contemplation of the parties that the excess values, if any, which might accrue through the years was to be compensation to the Taxpayer in 1938 or 1939, or any other year. It is necessary to draw a distinction between the option itself and what values actually might accrue under this option in subsequent years. The option itself was the only consideration for any services rendered, and when given, was only given for services rendered prior to December 10, 1934, the date of giving said option. Any increases in value of the common stock covered by the option during the course of years would be only that which would accrue to any owner of property and the gain or loss accruing fom such a transaction can never be adequately determined until a sale is made of the property. Under the

Commissioner's theory in this case, a tax would be imposed upon a fictitious profit or a paper profit fluctuating with the market value. If the Commissioner's theory were adopted in an instance of this kind, or even under these particular facts, there is no certainty that the Taxpayer would be able to sell his stock for the values fixed by the Commissioner at the time of delivery of the stock in 1938 or 1939. One could also assume that in the sale of the stock by the Taxpayer at a price less than the 1939 market value, the Commissioner would not allow a loss computed on the basis of market value in 1939, but would undoubtedly insist upon taxing the profits as a gain with the original cost as a basis.

The Commissioner, in his brief, page 26, indicates that in any particular case where the question is one of fact a determination of the Tax Court should be accepted as final if supported by substantial evidence. Respondent agrees that a finding of fact made by the Tax Court on disputed facts might be conclusive. In the case at bar, however, the facts were not disputed. The Commissioner accepted all of the evidence introduced by the respondent and did not see fit to introduce any evidence on behalf of the Commissioner. The Tax Court, in its findings of fact (R. 21 et. seq.) did not point to any evidence that it was the intention of the parties to compensate the taxpayer by way of increase in value of the stock which might be purchased

under the option. On the contrary the Tax Court in its opinion (R. 34) indicated that the transaction between Western Cooperage Company and John H. Smith was of such a nature that the effect in the taxable year upon petitioner's income tax liability *"involved a construction of law* which in and of itself is difficult." (Emphasis ours). Apparently the Tax Court experienced some hesitation in drawing its conclusions of law. We believe the application of the law to these particular facts was greatly clarified in the opinion written by the United States Circuit Court of Appeals in this case, 142 *Fed.* (2) 818, where the Court very aptly distinguished between the option agreement itself which was given as compensation, and the increase in value which accrued to the stock before the exercise of the option, which was not compensation. Under these circumstances it was very proper for the Circuit Court of Appeals to reverse the Tax Court.

The Commissioner asserts in his brief on page 10 that under the Treasury Regulations there is a strong presumption that all gains flowing from the employer-employee relationships are in the nature of compensation. We disagree with this assertion and if such a rule be adopted much confusion would result in taxation, as well as in the relationships between employer and employee. Under such a theory contractual rights between employer and employee would be prohibited

by reason of fear of uncertainties in taxation. Congress intended no such presumption or restriction.

In the field of taxation it has not been the practice of courts to read presumptions into the statutes or regulations. The only duty of the court is to interpret the intent of Congress as expressed in the statutes. Where there is a reasonable doubt as to the meaning of a taxing act it has uniformly been construed most favorable to the taxpayer. *Gould v. Gould* 245 *U. S.* 151, 38 *Sup. Ct.* 53, 62 *L. Ed.* 211. *White v. Aronson*, 302 *U. S.* 16, 58 *Sup. Ct.* 95, 82 *L. Ed.* 20.

The Commissioner believes that in a transaction of this kind, stock purchased under an agreement by an employee should be taxed as ordinary income. The Revenue Act, however, has set forth quite definitely the proper method of computing gains and losses on the acquisition and sale of capital assets. If it was the intention of Congress to tax capital gains as ordinary income, Congress certainly would have so provided in the statute. The statute, as enacted by Congress, permits capital gains and capital losses to be computed on a relatively comparable basis which is fair to all taxpayers. The theory of the Commissioner to tax such income as ordinary income in cases where stock is purchased under option agreements, would be grossly unfair to taxpayers, for the reason that they could not

take their capital losses on a comparable basis and be placed in a different classification from all other taxpayers with capital transactions.

We submit that the Commissioner in his brief does not point to any evidence in the record before the Tax Court which would indicate that the increase in value of the Hawley stock, as distinguished from the option agreement itself, was intended as compensation to John H. Smith. On the contrary the undisputed record indicates that the option itself was the only compensation given, and that was given in 1934. No further compensation was intended in 1938 or 1939 or any other year.

CONCLUSION

This Court should adopt the rule which became effective by the decision of the Circuit Court of Appeals in this case. The adoption of such a rule would avoid the use of fiction in determining the gains or losses of taxpayers and would require the gains or losses to be computed at the time of sale of a capital asset and would always require that the original cost thereof be used as a basis for computing the tax. This would prevent the use of devices by taxpayers with the apparent expectation of minimizing tax liability. It would prevent taxpayers from using a high base upon the exercise of an option. It would also enable the tax to be computed upon definite certainties and would not unjustly impose a tax upon a taxpayer by reason of fluctuating market values. Such a rule would also prevent corporations from taking unjustified deductions represented by high market value of securities for which they actually received less than the market value. Such a rule would also enable taxpayers to make their returns and pay their tax at a time when they actually received the money from the sale of capital assets, and are thereby enabled to pay the tax out of profits, if any.

We respectfully submit that the decision of the Circuit Court of Appeals for the Ninth Circuit is correct and should be affirmed.

Respectfully submitted,

Clarence D. Phillips,
Earl S. Nelson,
Franklin T. Griffith.

Of Counsel:
Griffith, Peck, Phillips & Nelson.
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